

# ICPS newsletter

## Sound Strategy in Fiscal Reform Is the Major Factor for Its Success

*An inefficient fiscal system has become the main obstacle for economic growth in Ukraine. Fiscal reform, which could change the situation, should encompass the following objectives: reduce tax rates, increase the tax base, streamline taxation procedures and strengthen tax collection and responsibility for tax evasion. Fulfilment such reform proves to be very difficult. In order to successfully carry out fiscal reform in this country, an implementation strategy should be developed, time should be determined, co-ordination among all responsible parties should be ensured and persons who have necessary competence and abilities should be made responsible for carrying out reform.*

*This conclusion can be drawn from the presentation delivered by Richard Laliberte, Chief of the Fiscal Reform Projects, Barents Group at the Macroeconomic Seminar at the International Centre for Policy Studies.*

### An Undefined Goal Impedes Fiscal Reform

There is still no consensus on the strategy, tactics and techniques for carrying out fiscal reform in Ukraine. This absence of consensus yields a situation when the Ukrainian government makes minor adjustments to the fiscal system instead of implementing major reform. The main goal of fiscal reform also cannot be clearly defined under the present situation. This goal should be long-term structural adjustments within the national economy and sustainable economic growth. The changes currently made to the Ukrainian fiscal system are primarily aimed at a quick increase of revenues to the state budget. Such changes produce a

negative impact onto the Ukrainian economic environment because they lead to excessive increases in the tax burden on economic agents.

The main goal of fiscal reform as undefined, concrete approaches to the fulfilment of changes cannot be determined. Due to the absence of a consensus on reform, the Ukrainian government cannot quickly carry out fiscal reform either as a single step, i.e. through adopting a package of tax regulations, a Tax Code, or in gradual steps. Absence of changes on the fiscal system makes annual budget modifications inevitable. The Ukrainian government has to sequester state expenditure in accordance with actual revenue every year.

**Victor Lysytskiy**, Chief Economic Advisor to Head of the NBU:

*"The tax burden in Ukraine is too big. To my mind, it cannot be analysed only in terms of macroeconomic indicators. The real picture can be drawn if we calculate the share of taxes in the production costs of enterprises from different branches of the Ukrainian economy. Only then shall we derive the real amount of tax burden on our enterprises".*

### Factors for Success

When analysing the possibilities of carrying out fiscal reform, certain factors should be considered. These factors can either guarantee the success of reform or doom its failure. One of the major factors is strength, i.e. real scope of powers of a government official responsible for tax reform (for instance, Deputy Prime-Minister for Economic Reform or Minister of Finance). Also important is the amount of authority of state agencies directly involved in implementing the changes: the State Tax Administration and/or the Ministry of Finance. Working relations between the Ministry of Finance and the State Tax Administration should be established. Eventually, the success of Ukrainian fiscal reform will depend on real strength of the government, its powers and responsibilities.

**Ihor Shumilo**, Deputy Minister of Economics:

*"The tax burden on Ukrainian economic agents can be illustrated as follows: of GDP*

+	27% — revenues of the Consolidated Budget
	10% — revenues to the Pension Fund
	37%
+	8% — debts to the budget
	45%
+	20% — tax exemptions
	65%

*The state applies the tax burden, which equals 65% of GDP, to collect 37% of GDP in the form of taxes. If we consider the quality of revenues, we shall find that only UAH 10 billion (10% of GDP) are collected in cash by the central government. This excessive tax burden hampers economic growth."*

## Last Week

**Why Are Ukrainian Enterprises Not Restructuring?** The International Centre for Policy Studies took part in the organisation of the round table "Restructuring Enterprises: State Policy and Success Stories of National Leaders". The round table was co-sponsored by the Cabinet of Ministers of Ukraine, Ministry of Economy of Ukraine, and State Administration of the Donetsk Oblast, and was held at the Donetsk Metallurgicheskyy Zavod (Donetsk Steel Works) on 23 April. Government officials, directors of big industrial enterprises and executives of commercial firms were in attendance.

The International Centre for Policy Studies was represented by Director Vira Naniivska. In her opening speech, Dr Naniivska stated that the main obstacle for restructuring was the absence of an efficient state industrial policy in Ukraine. The issue of restructuring enterprises should be brought to the level of state policy. The round table resulted in the preparation of recommendations on improving the conditions under which Ukrainian industrial enterprises operate and facilitating restructuring of Ukrainian enterprises. The recommendations were passed to relevant government agencies.

*A detailed report on the round table will be published later in the ICPS Newsletter.*

## This Week

**Designing an Economy-Friendly Fiscal System for Ukraine.** The ICPS Macroeconomic Seminar on 27 April will see a presentation by Hennady Balashov, Member of the Supreme Rada. The presentation will be entitled "Pros and Cons of a Single 10% Corporate and Income Tax".

Questions proposed for discussion are:

1. What are the main disadvantages of current state tax policy? What are more effective tax policy objectives?
  2. Why 10%?
  3. What will the tax base be?
  4. When will these changes occur (possible time lag)? Evaluation of possible revenues.
- How will state expenditures change? What liabilities will the state take? State role in the economy of Ukraine.

Please note that participation in the ICPS Macroeconomic Seminars held every Tuesday now require special invitation. To receive an invitation you should contact Larisa Romanenko, e-mail: LRomanenko@icps.kiev.ua, tel./fax +38044 4635967

**Volodymyr Lanovyi, President of the Market Reforms Centre:**

*"Ukrainian fiscal policy is inconsistent. No country in the world raised taxes when suffering from an economic crisis. Just the opposite, under crisis conditions tax rates must be cut. Introduction of a value added tax (i.e. tax on consumption) at a high rate was hardly a good decision under the conditions of an underdeveloped market. Permanent interference by the state with the depreciation policy of local enterprises (introduction of a reducing coefficient, withdrawal of a share of depreciation charges) also has a negative impact on economic development. Enterprises should be given full command over their depreciation policies. When carrying out fiscal reform, it should be made clear from the very start that tax cuts must be accompanied by the elimination of tax exemptions. Possible reduction in the amount of revenues to the state budget at the initial stage of fiscal reform (after tax cuts) should not be considered a major threat to the stability of the Ukrainian economy. Under the system of control over the budget being filled on a cash basis, existence of a huge fiscal deficit is almost impossible. The real threat for the Ukrainian economy is posed by systematic non-performance of obligations by the state from which a great many economic agents suffer today."*

Success or failure of tax reform will also be determined by the time of its implementation. For example, changes will be accepted more smoothly and chances on a successful outcome will considerably increase if reform starts when the Supreme Rada, especially its Budget Committee and the Finance and Banking Committee, are interested in the changes being implemented.

The success of fiscal reform will also depend on the qualities of government officials who are responsible for implementing changes. Such factors for success are:

- commitment to reforms;
- strong analytical skills;
- leadership in undertaking and implementing changes.

## Strategy for Implementing Fiscal Reform

Taking into account the success factors described above, the following is a strategy for implementing tax reform in Ukraine:

1. Determine the type, extent and time of reform. Output of this stage: strategy to be agreed with the Minister responsible for the reform.
2. Analyse and make recommendations on proposed changes. Output:

policy notes/tax reform briefing book.

3. Obtain preliminary approval from the Minister and the Government. Output: a tax reform "conceptual plan" paper.
4. Undertake consultations with selected affected groups. Output: development of consensus with affected groups.
5. Prepare tax legislation. Output: draft legislation prepared with assistance from local analysts and lawyers.
6. Present policy changes to the Cabinet of Ministers and legislation to the Supreme Rada and the President.
7. Prepare new or revised tax forms and regulations.
8. Implement changes. Output: issue new tax forms, provide training to tax administration officials on new measures, provide targeted information to taxpayers.
9. Monitor the impact of changes and fine tune legislation.

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*Macroeconomic seminar at the International Centre for Policy Studies "Fiscal Reform in Ukraine", 20 April 1999*

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